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Statement

Insurance Association of Connecticut

Insurance and Real Estate Committee

February 17, 2009

HB 6444 An Act Concerning Automobile Insurance

The Insurance Association of Connecticut opposes HB 6444, An Act Concerning Automobile Insurance, which would do severe harm to the state's automobile insurance marketplace and the state's insurance consumers.

Section 1 would put restrictions on the use of territorial rating. Over the past years the General Assembly has consistently rejected legislation which would eliminate or restrict the use of territorial rating. Section 1 of HB 6444 is no different.

Automobile insurance is sold in accordance with "cost-based pricing," which prices the insurance product according to the insurer's best estimate of how much the insured is likely to generate in claims, incorporating numerous rating factors (driving record, age of driver, age and model of car, miles driven, where the car is principally garaged, etc.) in order to develop rates equitably.

Territorial rating is an important part of cost-based pricing and is used in every state in the development of auto rates. In fact, actuarial studies have shown that territory is highly predictive of future risk, much more so than driving record. In Connecticut, territories must be approved by the Insurance Department prior to their use. Market conduct examinations provide the Department with additional regulatory oversight concerning the use of territories.

Ratemaking data is gathered, for purposes of territorial rating, using the "principal garaging rule." For example, if a driver from Simsbury causes an accident in Hartford, the claims costs associated with that accident are charged to Simsbury, not Hartford, for purposes of ratemaking. Similarly, if that Simsbury driver's car is vandalized in Hartford, the claims costs are again charged to Simsbury. The cost of insurance reflects different degrees of risk which consumers in different territories pose. This system is used throughout the country.

What makes Connecticut unique is that, pursuant to an administrative ruling issued in 1978, the use of "pure" territorial rating is not permitted. The effects of territorial rating are reduced by a factor of 25%, as insurers are only allowed to assign 75% weight to the actual loss experience of a territory (the so-called "75/25 rule"). Due to the 75/25 rule, Connecticut drivers in territories with lower loss costs are already subsidizing the premiums paid by drivers in higher loss cost territories.

Section 1 of HB 6444 will greatly expand the subsidization of rates paid by drivers in high risk territories by those in lower risk territories by providing that insurers will only be allowed to assign 50% weight to the actual loss experience of a territory, further adulterating ratemaking data and preventing insurers from using cost-based pricing. There is no actuarial justification for such a change. In addition, by making the change from 75/25 to 50/50 over 10 years, Section 1 will require insurers to annually incur additional administrative costs by reanalyzing and refiling rates due to the changes in permitted weights for territorial rating.

It is a simple, irrefutable fact, proven by decades of ratemaking data and numerous legislative and Insurance Department studies, that urban drivers are much more likely to incur auto insurance claims costs than non-urban drivers. This was again verified in 2001 by a study conducted by the National Conference of State Legislatures.

> It is a fact that policyholders from certain areas—usually higher density, more urban environs—as a group cause more at-fault accidents, and therefore, greater losses than do policyholders from other areas, as a group. (p. 61, Pricing Auto Insurance: A Study Of Ratemaking in Connecticut.)

In order to be fair, premiums must reflect that simple fact. To the contrary, section 1 of HB 6444 will cause a wholesale, and unfair, shifting of costs from high risk to low risk territories. This will result in auto insurance rates increasing for most drivers in the state.

States which had previously put restrictions on the use of territory in auto insurance ratemaking have recently and emphatically repealed those restrictions. Michigan, South Carolina and New Jersey found that those restrictive laws, which were intended to help urban drivers with the cost of their insurance, actually worked to the detriment of all drivers in their state, including urban residents. By preventing insurers from being able to price their products according to the cost of the product, these states found that such laws actually created counterproductive economic effects (fewer insurers, expanded assigned risk pool, higher costs) in urban areas and across their states. In fact, Michigan repealed its territorial restrictions in 1996, in order "to facilitate the purchase of insurance at fair and reasonable prices."

In lines 42-53, HB 6444 would establish restrictions on how certain expenses are loaded for purposes of calculating automobile insurance rates. We would point out that lines 51-53 contradict lines 46-50. Lines 46-50 say insurers can include certain expenses in bases rates, yet lines 51-53 state that these same expenses are added only after application of classification factors. It is not clear what is intended by this language, but it would appear to shift more premium costs to lower risk drivers.

In lines 121-124, HB 6444 would prevent insurers from using credit information for ratemaking purposes for private passenger automobile insurance. Section 2 would prevent declination, cancellation or nonrenewal based on credit information.

Insurers must be allowed flexibility in the underwriting and rating process in order that they may accurately predict the risk. Credit history information has been used by insurers for years. The correlation between credit history and loss experience is accepted as a proven tool of objective empirical validity. People with a personal history of poor credit management are more likely to have losses attributable to poor risk management.

There is no evidence of abuse in the use of this underwriting tool. Underwriting criteria are submitted to the Insurance Department. The Commissioner has the authority to disapprove the use of criteria found to be unfair or improper. Market conduct examinations and the Connecticut Unfair Insurance Practices Act also provide a sufficient regulatory oversight.

In fact, Connecticut is currently one of the most restrictive states in the country regarding the use of credit information. For new business, insurers are permitted, since March of 2001, to use "insurance scoring" models in the underwriting and rating of automobile insurance, as is permitted in at least 46 other states across the country.

An "insurance score" results from an objective, statistical analysis of credit report information, which identifies the relative likelihood of an insurance loss, based on the actual loss experience of individuals with similar financial positions.

The scoring model is developed by companies who analyze hundreds of thousands of records and establish predictive credit characteristics. Weights are assigned to the characteristics. The claimant's total score ranks the individual's credit history by their expected loss ratio and claim frequency. The higher the score, the lower the insurance risk.

The insurance scoring model does not consider any information on income, net worth, address, race, gender, age, nationality or marital status. In fact, it has been consistently shown that these scores have no relationship to income.

The Connecticut Insurance Department has established numerous consumer protections in its regulation of the use of credit information. Insurance scoring can only be used for new business; certain credit characteristics, such as the number of credit inquiries by a consumer or the consumer's total line of credit, cannot be used; a policy may not be declined, canceled or nonrenewed solely due to scoring; scoring programs may not penalize an applicant for having no credit history; reports must be filed by insurers with the Department on the results of using such scoring.

For over two years, the National Association of Insurance Commissioners conducted a study of the use of credit history in insurance underwriting and published a report on that study in 1997. The NAIC found no credible evidence of unfair discriminatory impact in the use of such information, and no credible evidence to challenge insurer's claims that such information serves as an accurate predictor of the likelihood of future losses.

In 1999, the Virginia Bureau of Insurance issued a report, entitled "Use of Credit Reports in Underwriting," which stated:

- “Based on the Bureau’s review of the characteristics used in the [scoring] models, the Bureau concluded that none of the characteristics appear to be unfairly discriminatory.”
- “Based on the Bureau’s findings, there appears to be concrete data indicating that a correlation exists between credit scores and losses.”

In 2003, the University of Texas released a study it conducted on the use of credit information (“A Statistical Analysis of the Relationship Between Credit History and Insurance Losses”). The study, which was funded by the state legislature, concluded that there was a “significant relationship” between an individual’s credit score and incurred losses, and that the “credit score did yield new information not contained in the existing underwriting variables.” The study’s conclusion stated “The lower a named insured’s credit score, the higher the probability that the insured will incur losses on an automobile insurance policy . . .”

In 2005, the Texas Department of Insurance issued a report, “Use of Credit Information By Insurers in Texas”, which stated that:

> “. . . credit score provides insurers with additional predictive information distinct from other rating variables. By using credit score, insurers can better classify and rate risks based on differences in claim experience.”

The Texas study also showed that the average loss per vehicle for people with the worst scores is double that of people with the best scores, and drivers with the best scores are involved in about 40% fewer accidents than those with the worst scores.

A 2006 study prepared by the Insurance Department in Arkansas found that, for 91% of policyholders, insurer use of credit information either had no impact or resulted in a decrease in the final premium.

The Federal Trade Commission issued a report to Congress ("Credit-Based Insurance Scores: Impact on Consumers of Automobile Insurance", July 2007). Included in the report's findings are the following:

- "Credit-based insurance scores are effective predictors of risk under automobile policies . . . The use of scores is therefore likely to make the price of insurance better match the risk of loss posed by the consumer." (p. 3)

- "Use of credit-based insurance scores may result in benefits for consumers. For example, scores permit insurance companies to evaluate risk with greater accuracy, which may make them more willing to offer insurance to higher-risk consumers for whom they would not be able to determine an appropriate premium." (p. 3)

Pursuant to the requirements of the Federal Fair Credit Reporting Act (which specifies insurance underwriting as one of the purposes of which credit information can be used), if an applicant is denied coverage based on credit information, the insurer must inform the applicant of the basis of that decision. The Connecticut Insurance Department also requires insurers to inform such applicants that they are entitled to a free copy of the credit report from the reporting company. Credit information is extremely accurate – the Association of Credit Bureaus reports less than one percent of all credit report challenges are proven to be errors.

A recent survey found that use of credit information has helped insurers write more policies. Insurers were able to accept some applicants because the credit-based insurance score results offset other information.

Credit history information is a legitimate tool, among others, which may be used by insurers in underwriting automobile insurance throughout the country. There is a proven link between credit history and risk of loss, which permits the insurer to accurately, objectively and consistently judge the risk presented.

Connecticut consumers are benefiting from a highly competitive auto insurance marketplace. Insurers are competing for business in the state on the basis of price, product and service. More insurers are coming in to engage in that market. Coverage is readily available in the standard market, as evidenced by the fact that the state's assigned risk pool has been markedly reduced in size (in October, 2008, there were only 23 applications made to the pool; versus a high of almost 200,000 drivers in 1988)). In recent years, overall rate changes for automobile insurance have been basically flat.

HB 6444, by placing artificial and counterproductive restrictions on the pricing and underwriting of products in that market, would cause unfair cost-shifting, impair the insurer's ability to judge risk, and do real harm to that marketplace, to the detriment of consumers across the state.

IAC urges rejections of section 1 and 2 of HB 6444.